PRT Forest Regeneration Income Fund

1998 Annual Report

PRT
Altogether a better approach™

Company Profile

PRT was established in British Columbia in 1988. It is Canada's largest forest nursery company, with 11 nurseries located in British Columbia, Alberta, Saskatchewan and Ontario. PRT produces in excess of 100 million top-quality seedlings a year.

Our mission is to offer quality nursery products to our customers. We do this by working with them to gain a full understanding of their reforestation requirements – whether in growing seedlings, treating seeds, providing storage, or other related products and services.

Contents

Financial Highlights

(in millions of dollars, except per unit amounts)

	Year ended December 31,1998	Period from July 11, 1997 to December 31,1997
Revenues	$ 22.1	$ 9.0
Operating Earnings	7.0	2.8
Net Earnings	4.0	1.9
Per Trust Unit	0.72	0.33
Distributable Cash	5.7	2.6
Per Trust Unit	1.02	0.47
Cash Distributions per Trust Unit	1.02	0.50
Cash Generated from Operations (before adjustment for non-cash items)	6.4	2.9
Additions to Capital Assets	5.9	3.3
Total Assets	61.1	79.8
Unitholders' Equity	50.4	52.1
Per Trust Unit	9.00	9.30
Price Range per Unit on the Toronto Stock Exchange:		
Installment Receipts		
High	6.75	7.20
Low	5.30	5.90
Closing Price at December 31, 1997	n/a	6.70
Fully Paid Units (effective July 11, 1998)		
High	10.25	n/a
Low	8.00	n/a
Closing Price at December 31, 1998	9.00	n/a

PRT
Altogether a better approach™

Pacific Regeneration Technologies has a proud heritage. Over the last ten years we have built a solid foundation in becoming

1988

- PRT is formed following an ambitious, $5.7 million employee ownership bid for six nurseries owned by the Province of British Columbia. Under the leadership of Charlie Johnson and Ev Van Eerden, the company becomes the largest privately owned forest seedling company in Canada. While much of the company's production is based on "bareroot" planting technology, plans get underway to transform the company's operations into superior "styroblock" containerized seedling production.

1989

- PRT develops the "Cool Box" for shipping seedlings for planting. The box improves storage conditions and survival, and later becomes an industry standard in western Canada.
- A PRT nursery receives the British Columbia Chief Forester's award for bareroot pine production.

1990

- PRT starts its move into new markets, with the establishment of another nursery in southern BC to grow seedlings for the Alberta market.

1991

- A PRT nursery wins the Chief Forester's award for western redcedar seedling production.

1992

- PRT expands its presence in British Columbia, with the opening of a nursery in Summerland, BC.

1993

- PRT broadens its plantation management services with the establishment of a yew tree plantation for Colorado based NaPro BioTherapeutics. NaPro intends to use the yew trees as a natural, renewable source of paclitaxol, an important ingredient in anti-cancer drugs.
- A PRT nursery wins the Chief Forester's award for coastal western redcedar production.

Canada's largest forest seedling nursery company.

1994

- PRT establishes its first location outside of British Columbia, in Beaverlodge, Alberta.
- PRT acquires Summit Nursery in Telkwa, BC, and John Kitchen, the Summit co-owner, joins the Company's management team, becoming VP Operations in 1997.

1995

- The industry marks the 25th anniversary of the styroblock container system, which by now has had a profound effect on PRT's operations. Container grown seedlings now account for over 90% of PRT's production, as compared to about 50% at the inception of the Company in 1988.

1996

- PRT acquires the Reid Collins nursery in Aldergrove, BC, further expanding the scope of its services by adding native plant production and seed processing capabilities.
- The Company continues to pursue markets outside of British Columbia, to diversify its nursery business base. PRT now produces over 75 million seedlings annually for over 100 contracted customers in western Canada.

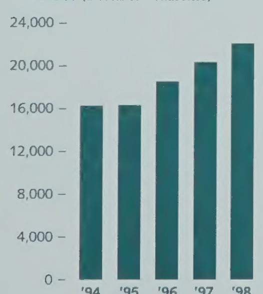
1997

- PRT accesses public capital markets with a $56 million unit trust offering on the Toronto Stock Exchange. This provides funds to recapitalize the company, buy out existing shareholders, and support further expansion.
- The Company continues its eastward expansion, by concluding a privatization agreement with the Government of Saskatchewan for its Prince Albert nursery.

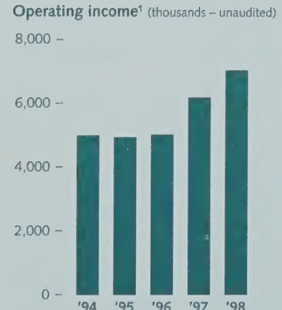
1998

- Further expansion follows, with the establishment of PRT Dryden, the Company's first facility in Ontario.
- An important partnering agreement is reached with Weyerhaeuser Canada. PRT acquires the ownership and management of Weyerhaeuser's nursery and seed orchard in Armstrong, BC, and receives a long-term seedling supply agreement.
- With recent acquisitions and expansion initiatives, PRT's operations now span 11 nurseries from BC to Ontario, with a combined production exceeding 100 million seedlings annually. The Company's market reach now extends throughout Canada and into the United States.

Revenues (thousands – unaudited)

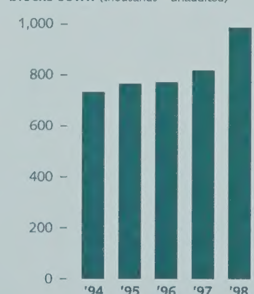


Operating income[1] (thousands – unaudited)

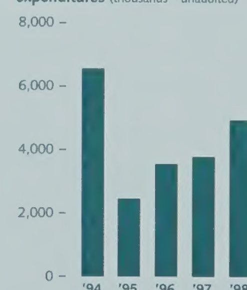


[1] Defined as earnings before corporate expenses, management fees, interest, depreciation, income taxes, other income and discontinued operations.

Annual contracted seedling blocks sown (thousands – unaudited)



Earnings enhancing capital expenditures (thousands – unaudited)



Our growth over the last ten years has not been without purpose. It has taken place in the pursuit of our vision, which is:

To maximize value for our Customers and Unitholders by becoming the industry leader in our core business, the mass production of forest seedlings for North American forestry companies. We will aggressively seek out opportunities to undertake any activity that can cost-effectively enhance performance or reduce establishment costs of the plantations managed by our Customers.

We will continue to pursue this vision, building on our foundation as Canada's largest forest seedling nursery company. This is our platform to expand into new regions, and our base for selling more value-added services to the forest industry.

As the forest industry continues to struggle to meet the challenges of a global marketplace, PRT will look for opportunities to become an important part of our customer's competitive strength. Companies will continue to look for opportunities to outsource, focus on core businesses, and consolidate their supply chain. PRT will respond by bringing its expertise in nursery and plantation management together with a broad range of related services and create value through strategic partnering relationships.

Similarly, the trend towards privatization by many governments will create expansion opportunities for a proven market leader like PRT.

As we embrace these opportunities, we will hold true to our belief that the key to understanding our customers needs and to building strong, lasting customer relationships is to have a presence in the markets in which they operate. It is because of this belief that we have developed an extensive, integrated network of nurseries to serve our customers better. Moreover, our success continues to prove our motto, that PRT has

"Altogether a better approach."

PRT
Altogether a better approach™

Evert Van Eerden
President & CEO
Pacific Regeneration Technologies Inc.

We are pleased to present to you the second annual report of the PRT Forest Regeneration Income Fund (the "Fund").

While 1998 marked only the second fiscal year for the Fund, the Fund's operating subsidiary, Pacific Regeneration Technologies, proudly celebrated its tenth anniversary of operations. Since PRT was formed following privatization of British Columbia government nurseries in 1988, it has earned a proud heritage and, through the combined contribution of our customers, employees, suppliers and stakeholders, has become Canada's leading forest nursery company. We particularly thank our employees for their efforts in this endeavour.

During 1998, the Company undertook several new initiatives designed to maintain and expand PRT's business and geographic diversification. These included: expansion of the nursery and addition of cold storage facilities at Beaverlodge, Alberta; construction of a 78,000 square foot (7200 square metres) nursery in Dryden, Ontario to more directly service customers in that area; and the purchase of Weyerhaeuser Canada's nursery and seed orchard in Armstrong, BC and the signing of an important long-term supply agreement. These projects have strengthened the Company's position in our present markets, and positioned the Company in new markets, with increased seedling capacity for 1999.

Consolidated net earnings for the year ended December 31, 1998 were $4.0 million or $0.72 per Unit. Distributable cash flow amounted to $5.7 million, or $1.02 per Unit. During the year the fund declared distributions to Unitholders of $1.02 per Unit, representing all available distributable cash flow.

The 1998 results were slightly below management's expectations, primarily as a result of two factors.

First, during the year, the Company gave notice of its intention to terminate its yew plantation agreement with NaPro BioTherapeutics. A new agreement covering the notice period is under discussion, and as a result, no revenues have been recorded since the notice was given. We are minimizing plantation expenditures until negotiations are concluded and revenues assured.

Second, the fall harvest, which takes place in November and December, resulted in a shortfall in yield at one nursery, coupled with higher than projected labour costs at some locations. Management has implemented changes to operating procedures to reduce the potential for similar problems in the future.

Partially mitigating the above factors were stronger than anticipated non-contracted seedling sales from surplus inventory.

The Board of PRT has continued to review the Company's distribution policy to ensure it best serves the interest of the Company and the Unitholders of the Income Fund.

The Company's business is seasonal, and this results in variations in distributable cash flow between quarters. Consequently, it is difficult for the Board to determine an appropriate level of dividend distributions for the year based solely on quarterly results.

Since the dividend component represents a relatively small portion of total annual distributions, the Board and Trustees are of the view that it would be more prudent to defer the payment of dividends until the results of operations for the full year are known.

Accordingly, effective with the first quarter of 1999, the Trust adopted a policy of distributing only the interest portion of distributable cash flow each quarter. An annual dividend will be declared and paid coincident with the first quarter distribution, based in the previous year's total distributable cash flow. This is a change in timing of distributions and will not affect the total amount distributed by the Trust for any fiscal year.

PRT achieved important expansion initiatives in 1998. Notwithstanding the current difficulties in the forest industry, and the resulting pressure on seedling prices, the Company's diversified network of nurseries is fully committed for 1999. Accordingly, the Trustees, Board and management believe PRT is solidly positioned to realize improved returns to Unitholders in the year ahead.

On behalf of the Trustees

COLIN A.C. DOBELL
Trustee

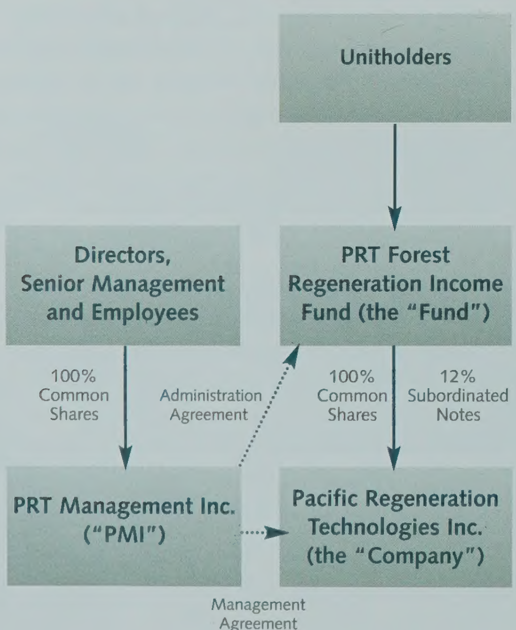
EVERT VAN EERDEN
President & CEO
Pacific Regeneration Technologies Inc.

The PRT Forest Regeneration Income Fund (the "Fund") is an open-ended, single-purpose trust, created under the laws of the Province of British Columbia, on May 14, 1997 to own all the common shares and subordinated notes of Pacific Regeneration Technologies Inc. (the"Company"). The Fund is restricted to investing in securities of the Company, making distributions to the Trust Unitholders and matters incidental thereto.

Management

Under a Management Agreement, PRT Management Inc. ("PMI") provides to the Company management and administration services and the services of the President, Vice-President, Finance and Administration and the Vice-President, Operations. Under an Administration Agreement, PMI provides administrative services to the Fund. The shares of PMI are owned by directors, officers and employees of PMI or PRT and its subsidiaries.

The structure is illustrated below.



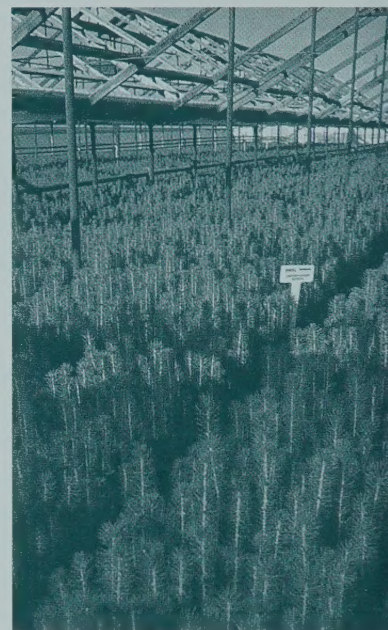
The Fund continues for a term ending 21 years after the date of death of the last surviving issue of Her Majesty, Queen Elizabeth II, alive on May 14, 1997. The Fund can also be terminated prior to expiry of the term by a special resolution passed by the Trust Unitholders or in the event the Fund ceases to own any securities of the Company.

Governance

The following description of the Fund's corporate governance practices is provided as required by the Toronto Stock Exchange ("TSE"), with reference to guidelines adopted by the TSE in 1995 (the "Guidelines").

The Declaration of Trust establishes a Board of Trustees to be comprised of not fewer than three nor more than five Trustees who are to be appointed annually at the annual general meeting of the Unitholders. At present, there are three Trustees, each of whom is unrelated to the Fund based on the definition contained in the Guidelines.

Pursuant to a Governance Agreement, the number of Directors of the Company is fixed at five. Of the five, three will be individuals approved by vote of the Unitholders at the annual general meeting of Unitholders and two will be nominated by PMI.



The Trustees are responsible for, among other things, acting for, voting on behalf of and representing the Fund as a shareholder and noteholder of the Company, maintaining records and providing reports to the Trust Unitholders, supervising the activities and managing the affairs of the Fund, and declaring distributions from the Fund to the Unitholders.

The Fund has an Audit Committee comprised of the Trustees. The Audit Committee is responsible for reviewing significant accounting, reporting and internal control matters, reviewing all published quarterly and annual financial statements and recommending their approval to the Trustees, and assessing the performance of the Fund's external auditors.

Communication with Unitholders on matters relating to the Fund is primarily the responsibility of the Chairman of the Board of Trustees.

Distributions and Taxation

The Fund will generally distribute interest received from the Company on a quarterly basis, and dividends received on an annual basis, less the Fund's administrative expenses and amounts which may be paid in connection with any cash redemptions of Units.

The Fund is a Unit Trust for income tax purposes. As such, the Fund is only taxable on any taxable income not allocated to the Unitholders. Generally, all taxable income of the Fund will be allocated to Unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the Unitholders.

The foregoing is a brief summary of only some of the taxation considerations relating to the Fund and the holding of Units and is not intended, in any way, to be complete nor to provide any legal or tax advice to Unitholders. Unitholders and prospective Unitholders should consult their own tax advisors.

The consolidated financial statements presented in this report are for the PRT Forest Regeneration Income Fund ("the Fund"). The Fund commenced operations on July 11, 1997 after acquiring the business of Pacific Regeneration Technologies Inc. ("PRT" or "the Company"). Accordingly, the comparative financial results are for less than a full fiscal year, covering the period from July 11, 1997 to December 31, 1997. Since the acquisition resulted in a significant financial restructuring of PRT, results for the predecessor company are not fully comparable to those of the Fund. Where operating figures from the pre-acquisition period are meaningful, they are provided.

During 1998, the Fund initiated several projects designed to further expand PRT's business and geographic diversification. These included the expansion of nursery and cold storage facilities in Beaverlodge, Alberta; construction of a 78,000 square foot (7200 square metres) nursery in Dryden, Ontario; and the purchase of Weyerhaeuser Canada's nursery and seed orchard in Armstrong, BC. These projects are expected to have a positive impact on the Fund's performance in future years.

Results of Operations

Net earnings for the 1998 fiscal year were $4.0 million ($0.72 per Unit), as compared to $1.9 million ($0.33 per Unit) for the shorter period in 1997. Distributable cash figures for the same periods were $5.7 million ($1.02 per Unit) and $2.6 million ($0.47 per Unit) respectively.

Revenues in 1998 reached $22.1 million. This represents an increase of 8.6% over total revenues achieved by PRT in the comparable twelve months of 1997. The increase in revenues resulted from a 20% increase in the number of seedling blocks sown, but was partially offset by lower revenues from yew plantation operations. The increase in block volume is mainly attributable to the Prince Albert nursery expansion, which was completed early in 1998. Yew plantation revenues however, declined as a result of the Company giving notice of its intention to cancel its plantation maintenance agreement with its customer. A new agreement covering the notice period is under discussion. However, as it is not assured, no revenues have been recorded since the date notice was given.

Costs of production were $11.5 million or 52% of revenues in 1998. This compares with $5.0 million or 55% of revenues in the 1997 period. The decrease in costs as a percentage of revenues reflects the effect of some minor operating efficiency gains, the impact of increasing volume on relatively fixed indirect costs, as well as lower costs resulting from the decrease in yew plantation operations. Partially offsetting these factors were higher than anticipated costs at some locations during the fall harvest, as well as a shortfall in yield at one nursery. Management has implemented changes to operating procedures to reduce the potential for similar problems in the future. Nursery administration costs increased to 15.0% of revenues from 12.7% in the prior period. This increase relates to certain one-time savings that occurred in 1997, as well as costs associated with expansion of the Company's operations in 1998. In 1999 this category is expected to remain close to 1998 levels.

Earnings before interest, depreciation, amortization, management fee and income taxes increased to 31.8% of revenues from 30.7% in the 1997 period. The improvement was mainly attributable to the reduction in costs of production, but was less than management's expectation due to the higher than anticipated fall harvest costs. With planned operating improvements, further gains are expected in 1999.

Interest costs in 1998 resulted from borrowings incurred to finance PRT's expansion initiatives, as well as other earnings enhancing capital projects. No interest costs were incurred in 1997 since the Company had a capital reserve fund which eliminated the need to borrow for its capital program.

Earnings before income taxes increased to 18.0% of revenues from 17.4% in the 1997 period, mainly as a result of lower production costs in 1998.

Income tax recoveries in 1998 declined from 1997 due to the one time effect of tax loss recoveries which were achieved in the prior period.

Cash Flow

The fund achieved distributable cash flow of $5.7 million ($1.02 per Unit) in 1998. Distributions totaling $1.02 per Unit were declared during the period.

Cash generated from operating activities totalled $6.4 million, as compared to $2.9 million for the shorter period in 1997. Distributions to unitholders totalled $5.7 million, equal to the full amount of distributable cash flow in the period.

Sustaining capital expenditures during the year totalled $228,000, as compared with $77,000 in the 1997 period. While sustaining capital expenditures increased on a *pro rata* basis from 1997, they remain less than the $400,000 per annum estimated in the Fund's prospectus. It is anticipated that future expenditures in this category will approach the estimated amount, adjusted for growth in PRT's business. Sustaining capital is funded from operating cash flow.

Expenditures for seedling containers totalled $749,000 during the year. These capital assets are funded from operating cash flow as container depreciation, which is recorded over a five-year period. For purposes of determining distributable cash flow, this cost is treated like a cash expense and is included in Costs of Production.

Earnings enhancing and strategic capital investments totalled $4.9 million in 1998, as compared to $3.1 million in the shorter 1997 period. Major projects undertaken during the year included:

- Completion of the expansion of the Prince Albert, Saskatchewan nursery facility which was initiated in 1997.
- The acquisition of Weyerhaeuser Canada's nursery and seed orchard operations at Armstrong, BC, and the construction of greenhouse facilities at the site. This project is scheduled for completion in 1999.
- Expansion of greenhouse and cold storage facilities at the Beaverlodge, Alberta nursery. This project was completed in 1998.
- Acquisition of land and construction of nursery facilities in Dryden, Ontario. The nursery will be completed and in operation in 1999.

Financing for these projects came from the $918,000 in unexpended capital reserve remaining from 1997, as well as drawings from the Company's term debt facility.

The Fund follows stringent guidelines to determine investment priorities. Projects must meet established return on investment criteria, or have strategic importance in order to be considered for approval. Earnings enhancing capital projects are financed using the Company's term debt facilities. Investment return hurdle rates are established with reference to the Fund's cost of capital, to ensure that net investment returns increase distributions to Unitholders.

Financial Position, Cash Resources and Liquidity

The Fund's working capital position at December 31, 1998 was $2.2 million, a decline of $0.6 million from the same period last year. This decline mainly resulted from funding the expansion of seedling containers, which temporarily exceeded the amount charged to operations as depreciation, and from the inclusion in current liabilities of term debt amortization scheduled for repayment in 1999.

Short-term bank indebtedness increased by $0.5 million compared to 1997, due to funding expected increases in non-cash working capital caused by growth of operations, and funding of the above-noted expansion of seedling containers.

During the year the Company arranged new credit facilities with the Canadian Imperial Bank of Commerce. Under the lending agreement, the Company has available up to $7.7 million under a revolving operating loan facility to fund working capital and general corporate requirements. At December 31, 1998 approximately $6.1 million was still available to be drawn under this facility. In addition, PRT arranged a revolving term facility of up to $15.0 million to finance acquisitions and other earnings enhancing capital expenditures. Drawings under the facility may be converted to non-revolving term loans with a ten-year amortization. Principal repayments under this facility are deducted in determining distributable cash in any year. At December 31, 1998, $5.0 million has been drawn and converted to term, while $10.0 million is still available for future capital programs.

Both of the above facilities were arranged on favourable interest terms, and are available in either US or Canadian dollars. Interest costs are based on Canadian prime or Bankers Acceptance rates, or in the case of US drawings are based on US Base or Libor rates.

On July 10, 1998 the Fund received the full amount of installments receivable of $4 per issued Trust Unit. These funds were paid out on July 13, 1998 to the selling shareholders of PRT, in accordance with the Fund's prospectus dated July 11, 1997. The Units traded on the Toronto Stock Exchange on a fully paid basis after this date.

Risks and Uncertainties

The Company's business involves the cultivation and growing of forest seedlings, an agricultural crop. As such, the business of PRT is subject to risks inherent in an agricultural business. To manage these risks, PRT grows much of its crop in climate-controlled greenhouses in diverse locations, and carefully monitors the growing conditions of its nurseries with trained growing personnel. In addition, the Company maintains insurance against certain crop losses.

The business of PRT is highly dependent on the forest industry in western Canada. While the Company is not materially dependent on any one customer, management remains concerned about the state of the coastal forest industry in British Columbia which has been impacted by changes in global markets and increased government regulation. These customers currently comprise approximately 7% of the Company's seedling contracts. While no material credit losses have occurred to date, management is closely monitoring its credit exposure in this area. In addition, PRT continues to pursue expansion opportunities in other geographic areas, which will reduce the Company's relative exposure to the region.

The Company intends to use term debt financing to fund earnings enhancing capital expenditures. Interest rate risk is managed by fixing term debt rates for the life of the obligation using interest rate swaps. Working capital loans are short term in nature and represent a relatively small portion of total borrowings. Accordingly, management does not hedge interest rate risk on this debt.

The Company maintains an extensive network of computerized management information and greenhouse climate control and monitoring systems. Each of these systems has been thoroughly examined to determine the extent to which they may be affected by the change in the calendar year on January 1, 2000. The Company has determined that all of its key computerized systems are year 2000 compliant. In addition, an assessment of the readiness of third parties such as customers, suppliers and others is ongoing, and the Company believes that it has no material exposure to the year 2000 issue from third parties.

Outlook

The expansion initiatives undertaken by PRT in 1997 and 1998 have led to a significant increase in seedling capacity and a more diversified market exposure. With the 1999 marketing season nearing completion, the Company has fully committed its greenhouse space. Although the current difficulties in the BC forest industry have softened seedling prices in that region, the Company's presence in other key markets has served to reduce this impact. Accordingly, management expects that revenues and distributable cash will increase in 1999.

In addition, PRT continues to investigate opportunities to broaden its focus into new markets and related services. As we expand our market base we develop closer ties to our customers, and further solidify our market leadership position. We expect 1999 will continue to present new growth opportunities.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of PRT Forest Regeneration Income Fund (the "Fund") and all the information in this annual report pertaining to the Fund have been prepared by PRT Management Inc. ("PRT Management") and management of Pacific Regeneration Technologies Inc. ("PRT") and have been approved by the Board of Trustees of the Fund.

The financial statements have been prepared by PRT Management in accordance with generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgements. PRT Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly in all material respects. PRT Management has prepared the financial information of the Fund presented elsewhere in the annual report and has ensured that it is consistent with the financial statements of the Company.

PRT Management maintains on behalf of the Fund systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. Such systems are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that assets are appropriately accounted for and adequately safeguarded.

The Trustees of the Fund are responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements of the Fund. The Trustees carry out this responsibility in this capacity as its Audit Committee.

The Audit Committee is comprised of the three Trustees, all of who are independent and unrelated to the Fund. The Committee meets periodically with PRT Management and management of PRT as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is properly discharging its responsibilities, and to review the annual report, the financial statements and the external auditors' report. The Committee also considers, for approval by the Unitholders, the engagement or re-appointment of the external auditors.

The consolidated financial statements of the Fund have been audited by PricewaterhouseCoopers, the external auditors, in accordance with generally accepted auditing standards on behalf of the Unitholders. PricewaterhouseCoopers has full and free access to the Audit Committee.

On behalf of the Trustees

COLIN A.C. DOBELL
Trustee

EVERT VAN EERDEN
President & CEO
PRT Management Inc. and
Pacific Regeneration Technologies Inc.

March 5, 1999

To the Unitholders of PRT Forest Regeneration Income Fund

We have audited the consolidated balance sheet of PRT Forest Regeneration Income Fund (the "Fund") as at December 31, 1998 and 1997 and the consolidated statements of earnings and distributable cash, Unitholders' equity and changes in financial position for the year ended December 31, 1998 and the period from July 11, 1997 to December 31, 1997. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the year ended December 31, 1998 and the period from July 11, 1997 to December 31, 1997 in accordance with generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Vancouver, Canada
February 10, 1999

	December 31 1998	December 31 1997
ASSETS		
Current Assets		
Accounts receivable	$ 5,922,274	$ 5,715,119
Inventories	870,293	819,544
Prepaid expenses	182,665	130,364
Installments receivable *(note 5)*	–	22,422,856
Unbilled revenue	790,685	872,719
	7,765,917	29,960,602
Capital Assets *(note 3)*	24,572,382	20,332,884
Goodwill	28,723,712	29,469,224
	$ 61,062,011	$ 79,762,710
LIABILITIES		
Current Liabilities		
Operating line *(note 9)*	$ 1,641,149	$ 1,152,700
Accounts payable and accrued liabilities	2,194,976	2,157,680
Distribution payable to Unitholders *(note 7)*	1,401,428	1,401,428
Current portion of long-term debt *(note 10)*	317,636	–
Installments payable *(note 4)*	–	22,422,856
	5,555,189	27,134,664
Long-term Debt *(note 10)*	4,649,864	–
Deferred Income Taxes	413,815	499,888
	10,618,868	27,634,552
UNITHOLDERS' EQUITY *(note 5)*	50,443,143	52,128,158
	$ 61,062,011	$ 79,762,710

On behalf of the Trustees

COLIN A.C. DOBELL
Trustee

DAVID C. DAVENPORT
Trustee

	Year ended December 31,1998	Period from July 11, 1997 to December 31,1997
Revenue	$ 22,097,279	$ 9,013,327
Expenses		
Costs of production	11,506,567	4,997,471
Nursery administration	3,311,998	1,149,143
Fund administration	246,394	101,655
	15,064,959	6,248,269
Earnings before interest, depreciation, amortization, management fee and income taxes	7,032,320	2,765,058
Interest	204,720	–
Depreciation	1,285,551	455,913
Amortization of goodwill	745,512	351,481
Management fee *(note 8)*	825,000	388,105
Earnings before income taxes	3,971,537	1,569,559
Recovery of income taxes *(note 6)*	68,771	306,912
Net earnings	4,040,308	1,876,471
Net earnings adjustments:		
Depreciation	1,285,551	455,913
Amortization of goodwill	745,512	351,481
Deferred income taxes	(86,073)	42,664
Repayment of long-term debt	(32,500)	–
Sustaining capital expenditures	(227,752)	(76,825)
Distributable cash	$ 5,725,046	$ 2,649,704
Net earnings per Trust Unit	$ 0.72	$ 0.33
Distributable cash per Trust Unit	$ 1.02	$ 0.47

CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

	Year ended December 31,1998	Period from July 11, 1997 to December 31,1997
Opening Unitholders' equity	$ 52,128,158	$ –
Net proceeds from issuance of Trust Units	–	53,054,543
Net earnings	4,040,308	1,876,471
Distributions declared during the period	(5,725,323)	(2,802,856)
Balance – end of period	$ 50,443,143	$ 52,128,158

	Year ended December 31,1998	Period from July 11, 1997 to December 31,1997
Cash provided from (used for):		
Operating Activities		
Distributable cash	$ 5,725,046	$ 2,649,704
Repayment of long-term debt	32,500	–
Sustaining capital expenditures	227,752	76,825
Seedling container depreciation which is included in costs of production	393,136	196,383
	6,378,434	2,922,912
Changes in non-cash working capital balances	(190,875)	(4,222,115)
	6,187,559	(1,299,203)
Financing Activities		
Issuance of Trust Units	–	56,057,140
Cost of issuance	–	(3,002,597)
Distributions paid to Unitholders	(5,725,323)	(1,401,428)
Repayment of assumed bank indebtedness *(note 1)*	–	(17,506,192)
Payment of accrued dividend to former shareholders of PREH *(note 1)*	–	(4,220,352)
Net proceeds of long-term debt	4,967,500	–
	(757,823)	29,926,571
Investing Activities		
Acquisition of PREH *(note 1)*	–	(26,485,948)
Purchase of capital assets	(5,926,892)	(3,310,453)
Proceeds on sale of capital assets	8,707	16,333
	(5,918,185)	(29,780,068)
Decrease in cash position	(488,449)	(1,152,700)
Operating line – beginning of period	(1,152,700)	–
Operating line – end of period	$ (1,641,149)	$ (1,152,700)

FOR THE YEAR ENDED DECEMBER 31, 1998 AND THE PERIOD FROM JULY 11, 1997 TO DECEMBER 31, 1997

1. Organization, Acquisition and Nature of Operations

PRT Forest Regeneration Income Fund (the "Fund") is an open-ended single purpose trust, created under the laws of British Columbia by a Declaration of Trust dated May 14, 1997. The Fund is the largest producer of container-grown forest seedlings in North America. The Fund grows its seedlings at eight nurseries in British Columbia, and one in each of Alberta, Saskatchewan and Ontario.

The Fund was created to acquire 100% of the issued and outstanding shares of Pacific Regeneration Employees Holdings Inc. ("PREH"). The acquisition of common shares was financed by a public issue of Trust Units of the Fund *(note 5).*

Effective July 11, 1997, the Fund acquired PREH for total consideration of $30,553,426 consisting of cash of $8,130,570 and an installment of $22,422,856 payable on or before July 10, 1998. The acquisition has been accounted for using the purchase method, whereby the value of the consideration given is allocated to the assets and liabilities of PREH on the basis of the estimated fair values thereof. The results of PREH have been included in the accounts of the Fund from the date of acquisition.

Net assets acquired at fair market value	
Net working capital other than cash and accrued dividend	$ 1,157,951
Capital assets	17,691,060
Accrued dividend to former shareholders of PREH	(4,220,352)
Bank indebtedness assumed	(17,506,192)
Deferred income taxes	(457,224)
Goodwill	29,820,705
	26,485,948
Cash	4,067,478
	$ 30,553,426

Total consideration	
Cash	$ 8,130,570
Installment payable	22,422,856
	$ 30,553,426

The following transactions were completed immediately subsequent to the acquisition:

a) The Fund sold its interest in PREH to its wholly owned subsidiary (Acquisitionco) for total consideration of $30,553,426 consisting of $6,110,685 of common shares and $24,442,741 of 12% unsecured subordinated notes (the "Notes").

b) Acquisitionco, an inactive holding company, PREH and certain other of its subsidiaries were amalgamated to form a new company called Pacific Regeneration Technologies Inc. ("PRT" or the "Company").

c) The Fund subscribed for an additional $4,200,000 of common shares of PRT and $16,800,000 of Notes of PRT.

d) PRT repaid outstanding bank indebtedness of $17,506,192 and the accrued dividend to the former shareholders of PREH of $4,220,352.

2. Significant Accounting Policies

Basis of financial statements

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

Principles of consolidation

These consolidated financial statements include the accounts of the Fund, PRT and its wholly owned subsidiary companies. Interest on the Notes and other inter-group transactions are eliminated on consolidation.

Revenue recognition

Revenue from contracts is recognized as a percentage of the contract price, based on the percentage of total direct expenses incurred to total budgeted direct costs. Total revenue is recognized when seedling crops reach substantial completion, which is defined as meeting all contracted growth specifications. Any excess of revenues recorded using this percentage completion method over amounts billed, is recorded as unbilled revenue.

Inventories

Inventories of supplies are recorded at the lower of cost and replacement cost.

Capital assets and depreciation

Capital assets are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method at rates which reflect the estimated useful lives of the assets as follows:

Buildings	40 years
Greenhouses	25 years
Equipment	3–15 years
Seedling containers	5 years

Depreciation related to the seedling containers is included in costs of production in the consolidated statements of earnings and distributable cash.

Goodwill

Goodwill is amortized over its estimated useful life of 40 years, using the straight-line method. The Trustees review the valuation and amortization of goodwill on an ongoing basis, taking into consideration any events and circumstances that might have impaired the value. Goodwill is written down when declines in value are considered to be other than temporary based upon forecast future cash flows.

FOR THE YEAR ENDED DECEMBER 31, 1998 AND THE PERIOD FROM JULY 11, 1997 TO DECEMBER 31, 1997

2. Significant Accounting Policies ...continued

Distributions to Unitholders

Distributions to Unitholders are made on a quarterly basis. The amount of cash to be distributed annually to Unitholders is made with reference to distributable cash, which is calculated as net earnings adjusted for depreciation, amortization, deferred taxes, sustaining capital expenditures and debt repayment. In the event earnings enhancing capital expenditures are not debt financed, distributable cash will be reduced by these expenditures as incurred.

Income taxes

The Fund is a Unit Trust for income tax purposes. As such, the Fund is only taxable on any taxable income not allocated to the Unitholders. During 1998 and 1997, all taxable income of the Fund has been allocated to the Unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the Unitholders.

PRT and the Fund's other subsidiaries follow the tax allocation method of accounting for income taxes, whereby earnings are charged with income taxes relating to reported earnings. Differences between such taxes and taxes currently payable or recoverable are reflected in deferred income taxes and arise because of differences between the time certain items of revenue and expenses are reported in the accounts and the time they are reported for income tax purposes.

The income tax recovery recorded in these consolidated financial statements is based on the consolidated tax position of the Fund and its subsidiaries.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual amounts could differ from those estimates.

Financial instruments

Financial instruments are classified in accordance with the substance of the contractual arrangement. The carrying values of financial assets and liabilities are considered to approximate fair values.

3. Capital Assets

	December 31, 1998			December 31, 1997
	Cost	Accumulated depreciation	Net	Net
Land	$ 2,427,146	$ –	$ 2,427,146	$ 2,049,407
Nursery growing facilities	16,401,731	(826,126)	15,575,605	13,734,548
Equipment	6,312,118	(910,811)	5,401,307	3,736,795
Seedling containers	1,757,842	(589,518)	1,168,324	812,134
	$ 26,898,837	$ (2,326,455)	$ 24,572,382	$ 20,332,884

4. Installments Payable

Installments payable represents the final installment due on the purchase of PREH *(note 1)*. The amount was paid on July 13, 1998.

5. Unitholders' Capital

The Declaration of Trust provides that an unlimited number of Trust Units may be created and issued. Each Trust Unit represents an equal undivided beneficial interest in the assets of the Fund. All Trust Units of the Fund are of the same class with equal rights and privileges. Each Trust Unit is transferable, and entitles the holder thereof to participate equally in allocations and distributions and to one vote for each whole Trust Unit held at all meetings of Unitholders. Unitholders are not subject to future calls or assessments.

Trust Units are redeemable at the holder's option at amounts related to market prices at the time, subject to a maximum of $75,000 in cash redemptions by the Fund in any particular month. This limitation may be waived at the discretion of the Trustees. Redemption in excess of this amount, assuming no waiving of the limitation, shall be paid by way of a distribution in specie of a *pro rata* number of PRT common shares and Notes.

Under a prospectus dated June 26, 1997, the Fund issued 5,605,714 Trust Units at a price of $10 per Unit on an installment basis. The Unit price was payable in cash of $6 per Unit on July 11, 1997 and a final installment of $4 per Unit was received on July 10, 1998.

Units outstanding as at December 31, are:

	Number of Units	1998	1997
Public issue of Units	5,605,714	$ 56,057,140	$ 56,057,140
Less: issue expenses	–	3,002,597	3,002,597
Balance – December 31	5,605,714	$ 53,054,543	$ 53,054,543

FOR THE YEAR ENDED DECEMBER 31, 1998 AND THE PERIOD FROM JULY 11, 1997 TO DECEMBER 31, 1997

6. Income Taxes

The consolidated income tax recovery has been determined as follows:

	1998	1997
Income tax expense computed at statutory rates	$ 1,811,815	$ 715,719
Permanent differences	(1,897,888)	(673,055)
Tax recovery from prior periods	–	(366,176)
Large Corporations Tax	17,302	16,600
	$ (68,771)	$ (306,912)
The recovery of income taxes is comprised of the following:		
Current income taxes	$ 17,302	$ (349,576)
Deferred income taxes	(86,073)	42,664
	$ (68,771)	$ (306,912)

7. Distributions to Unitholders

During the year ended December 31, 1998, the Fund declared distributions to the Unitholders of $5,725,323 or $1.02 per Unit (period from July 11, 1997 to December 31, 1997 – $2,802,856 or $0.50 per Unit). The amounts and record dates of these distributions were:

	1998		1997	
	Amount	Per Unit	Amount	Per Unit
March 31	$ 1,401,428	$ 0.25	$ –	$ –
June 30	1,681,714	0.30	–	–
September 30	1,240,753	0.22	1,401,428	0.25
December 31	1,401,428	0.25	1,401,428	0.25
	$ 5,725,323	$ 1.02	$ 2,802,856	$ 0.50

The distribution of $1,401,428 with a record date of December 31, 1998 was accrued at year end and paid on January 15, 1999.

The costs of issuing Trust Units incurred by the Fund of $3,002,597 are deductible for income tax purposes on a straight-line basis over a five-year period. The Fund can designate these deductions as a non-taxable distribution of amounts to Unitholders. The distributions declared in 1998 have been allocated as follows for income tax purposes:

		Per Unit		
	Total	Taxable	Non-taxable	Total
Interest income	$ 4,924,029	$ 0.7713	$ 0.1071	$ 0.8784
Dividends	801,294	0.1429	–	0.1429
Total distribution	$ 5,725,323	$ 0.9142	$ 0.1071	$ 1.0213

As at December 31, 1998, $2,117,448 of issue costs were available for future designation as non-taxable distributions.

8. Administration and Management Agreements

FOR THE YEAR ENDED DECEMBER 31, 1998 AND THE PERIOD FROM JULY 11, 1997 TO DECEMBER 31, 1997

Administration Agreement

The Fund has entered into an Administration Agreement with PRT Management Inc. ("PRT Management"), a company owned by certain of the former shareholders of PREH. The Agreement provides that PRT Management will provide or arrange for the provision of administration services to the Fund. PRT Management is entitled to reimbursement of out-of-pocket expenses for providing these services but will not earn a fee. The Agreement has a 20-year term and can be terminated by the Fund in certain circumstances.

Management Agreement

PRT has entered into a Management Agreement with PRT Management. The Agreement provides that PRT Management will provide management and administration services and strategic advice to PRT and provide individuals to serve as President, Vice-President, Finance and Administration, and Vice-President, Nursery Operations. The initial term of the Agreement is 20 years, and it is renewable thereafter for successive five-year terms unless PRT gives notice of non-renewal at least 12 months before the end of the relevant term. The Management Agreement may be terminated by PRT or PRT Management in certain circumstances. PRT Management earns a fee of $825,000 per annum plus reimbursement of certain out-of-pocket expenses for providing these services. In addition, as an incentive to PRT Management to enhance the profitability of PRT and cash distributions to Unitholders of the Fund, PRT Management is entitled to earn incentive fees which will be payable annually when the per Unit cash distributions to Unitholders generated from the operations of PRT exceed certain defined levels.

During the year, PRT Management earned a fee of $825,000 (period from July 11, 1997 to December 31, 1997 – $388,105) under the Management Agreement. No incentive fees were earned by PRT Management during the year.

As at December 31, 1998, no amounts were owing from PRT Management Inc. (1997 – $220,892).

9. Operating Line

PRT has a revolving operating facility available in the amount of $7.7 million to fund the working capital and general corporate requirements of the Company. At December 31, 1998, the Company had drawn $1,641,149 from the facility in the form of a Banker's Acceptance bearing interest at 6.01%. A first floating charge over the Company's assets is provided as security.

FOR THE YEAR ENDED DECEMBER 31, 1998 AND THE PERIOD FROM JULY 11, 1997 TO DECEMBER 31, 1997

10. Long-term Debt

PRT has a revolving term facility available in the amount of $15,000,000 or the equivalent in US dollars. Under the credit facility, PRT may borrow by way of Prime and/or Base rate drawings, Bankers' Acceptance drawings, and/or LIBOR drawings.

On or before the annual revolvement date, PRT may, at its option, extend the facility for 1 year or elect to convert all or a portion of the principal amounts owing into a non-revolving term loan. As at December 31, 1998, the following amounts have been drawn and converted into non-revolving term loans:

	December 31, 1998
Repayable in quarterly installments of $33,379 commencing June 28, 1999 and maturing on June 26, 2008. An additional payment of $32,500 is due on March 26, 1999. Interest rate has been fixed by way of interest rate swaps for the term at 5.69% plus 0.875% – 1.5% stamping fee.	$ 1,267,500
Repayable in quarterly installments of $92,500 commencing September 30, 1999, and maturing on June 30, 2009. Interest rate has been fixed by way of interest rate swaps for the term at 5.595% plus 0.875% – 1.5% stamping fee.	$ 3,700,000
	4,967,500
Less current portion:	(317,636)
	$ 4,649,864

A first floating charge over the Company's assets is provided as security.

The principal repayments required in each of the next five years are as follows:

Year ending December 31, 1999	$ 317,636
2000	$ 503,516
2001	$ 503,516
2002	$ 503,516
2003	$ 503,516

11. Commitments

PRT has operating lease commitments for certain greenhouse facilities. Future minimum payments over the next five years are as follows:

Year ending December 31, 1999	$ 132,430
2000	$ 132,430
2001	$ 132,430
2002	$ 132,430
2003	$ 132,430

12. Uncertainty Due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations.

The Fund has performed a thorough examination of its network of systems, to determine the extent to which they may be affected by the change in calendar year on January 1, 2000. In addition, an assessment of the readiness of third parties such as customers, suppliers and others is ongoing. However, it is not possible to be certain that all aspects of the Year 2000 Issue affecting the Fund, including those related to the efforts of customers, suppliers or other third parties, will be fully resolved.

PRINTED IN CANADA

Fund Information

Trustees
David C. Davenport
Partner, Davis & Company
Law Firm

Colin A.C. Dobell
President, C. Dobell Inc.
Financial Consulting Firm

Allan D. Laird
President, A.D. Laird Consulting Ltd.
Management Consulting Firm

Annual Meeting
The annual meeting of Unitholders will be held at 9 am, May 7, 1999 at the Hotel Vancouver, in the Cortes Island Room, 900 West Georgia Street, Vancouver, British Columbia

Company Information

Directors
David C. Davenport
Partner, Davis & Company
Law Firm

Colin A.C. Dobell
President, C. Dobell Inc.
Financial Consulting Firm

Allan D. Laird
President, A.D. Laird Consulting Ltd.
Management Consulting Firm

Evert Van Eerden
President, PRT Management Inc.

Robert A. Miller
Vice President, Finance
PRT Management Inc.

Officers
Evert Van Eerden
President, PRT Management Inc.

Robert A. Miller
Vice President, Finance and Secretary
PRT Management Inc.

John Kitchen
Vice President, Operations

Principal Office
#4 – 1028 Fort Street
Victoria, British Columbia
Canada, V8V 3K4
Telephone: (250) 381-1404
Facsimile: (250) 381-0252

Registrar and Transfer Agent
Montreal Trust Company of Canada
Vancouver, Calgary, Toronto and Montreal

Stock Exchange Listing
Toronto Stock Exchange

Trading Symbol
PRT.UN

PRT™
Altogether a better approach™

PRT
Altogether a better approach™

Principal Office
#4 – 1028 Fort Street
Victoria, British Columbia
Canada, V8V 3K4

(250) 381-1404 TELEPHONE
(250) 381-0252 FACSIMILE